Non-Bank Financial Institutions

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Three main objectives

- Definition of Non-Bank Financial Institutions (NBFIs)
- Factors behind the growth of NBFIs
- Why do NBFIs matter for the Fed?

NBFIs as financial "Go-Between"

"Textbook" Financial Intermediation

Investors → Banks → Capital Users

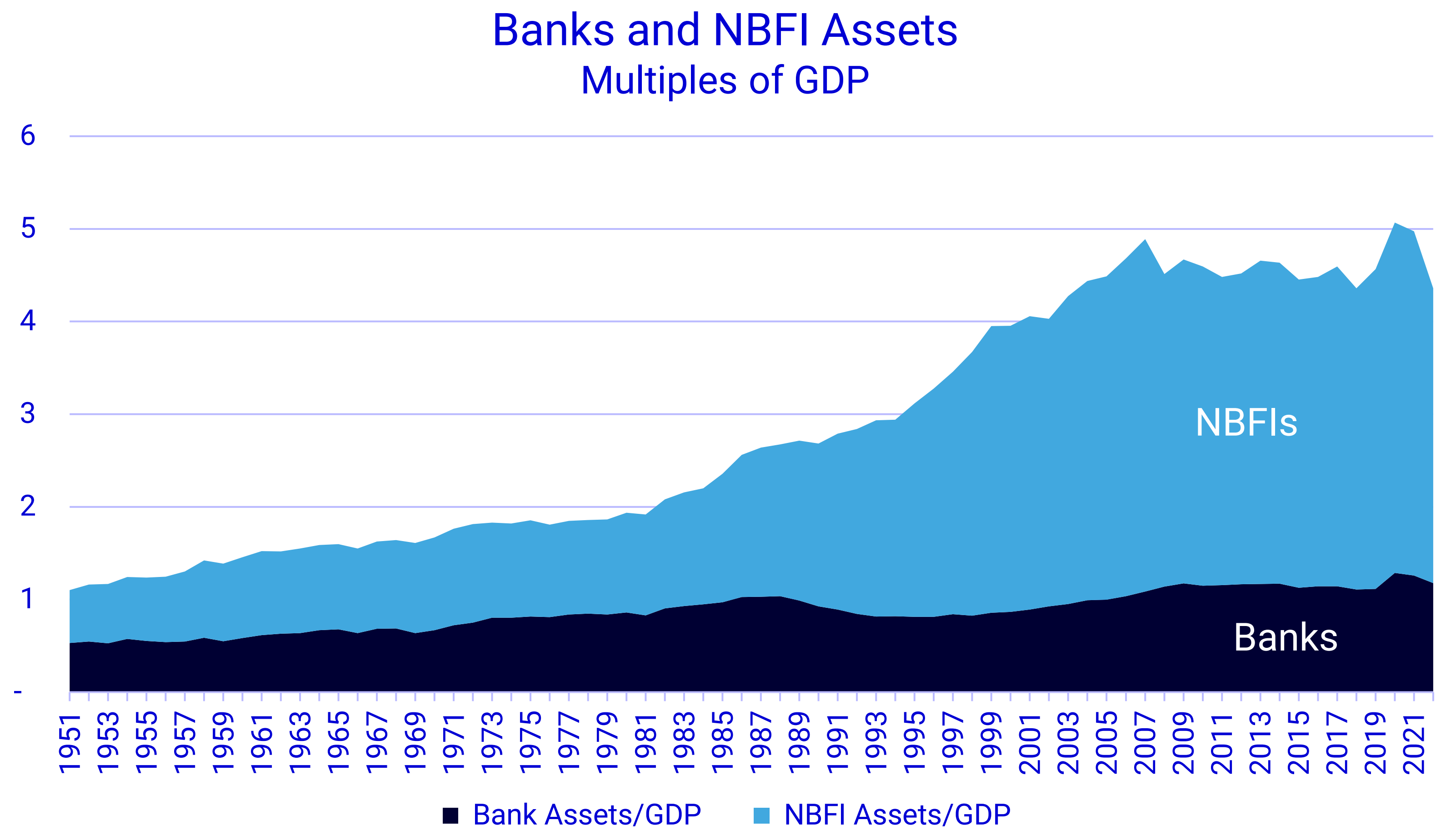
"Modern" Financial Intermediation

Investors →

- Banks
- Money Market Funds
- Bond/Equity Funds
- ETFs
- Hedge Funds
- Pension Funds
- Insurance Companies
- Securities Brokers and Dealers
- Mortgage Companies
- Credit Card Companies
- Captive Finance
- Private Credit Funds
- Private Equity Funds
- Real Estate Investment Trusts
- Asset-Backed Securities Issuers
- Payday Lenders

→ Capital Users

NBFIs have outgrown banks



Source: Financial Accounts of the United States; U.S. Bureau of Economic Analysis

Multiple factors behind emergence of NBFIs

- Innovation
- Regulation / Regulatory arbitrage
- Institutional drivers

NBFIs affect monetary policy

- Traditionally, banks played primary role in of monetary policy actions to financial system and economy

- With NBFIs, heightened complexity of implementation and transmission of monetary policy

NBFIs impact financial stability

- Financial intermediation is risky. Banks heavily monitored and regulated, AND provided official backstops (deposit insurance and access to central bank liquidity)

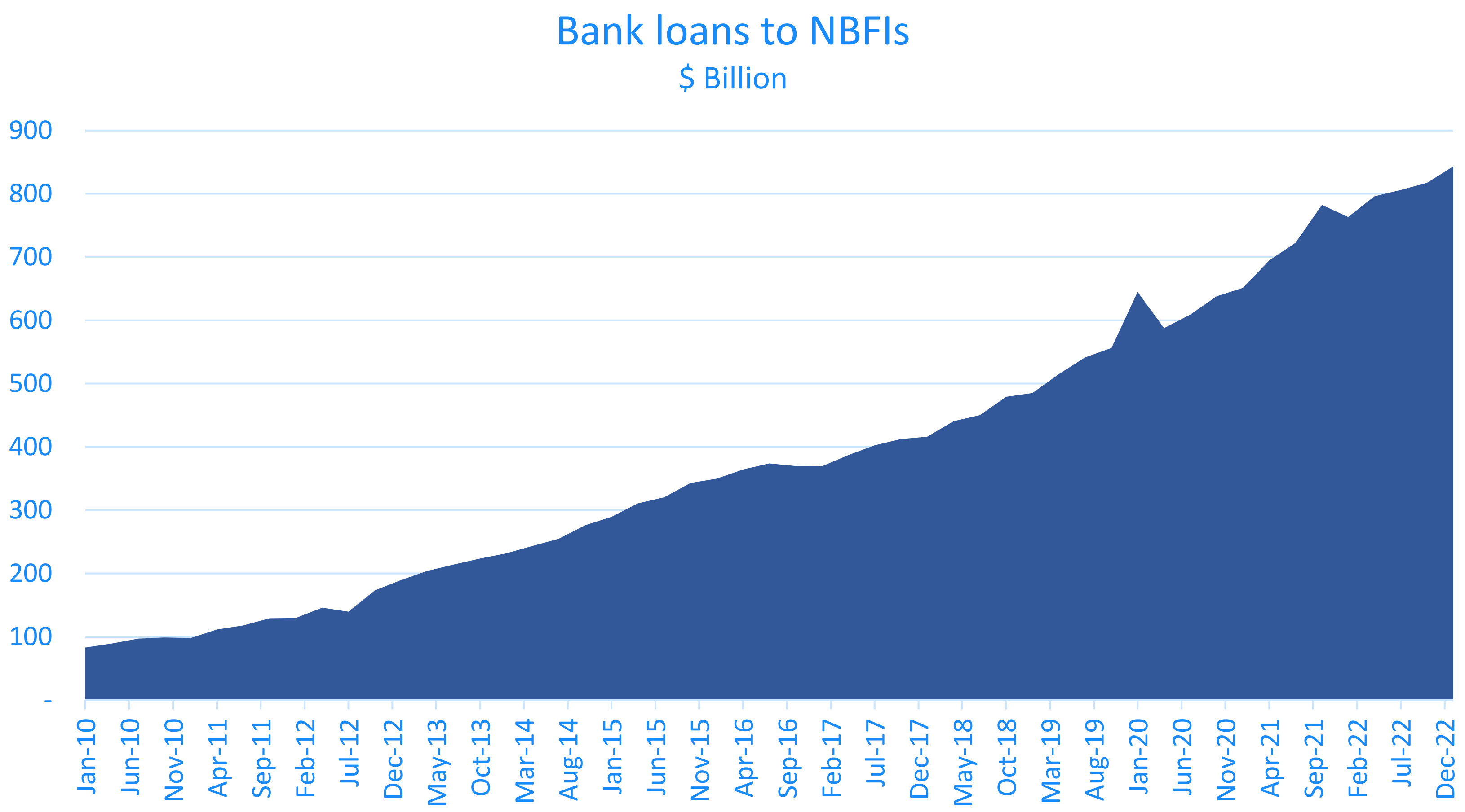
- NBFIs not subject to prudential standards (or only limited), and no official backstops

- Historical examples:
  - Long Term Capital Management (LTCM) distress in 1998
  - Money Market Funds “breaking the buck” in 2008
  - Bear Stearns and Lehman, and AIG in 2008
  - Mutual Funds disruption in March 2020

NBFIs interconnected with Banks

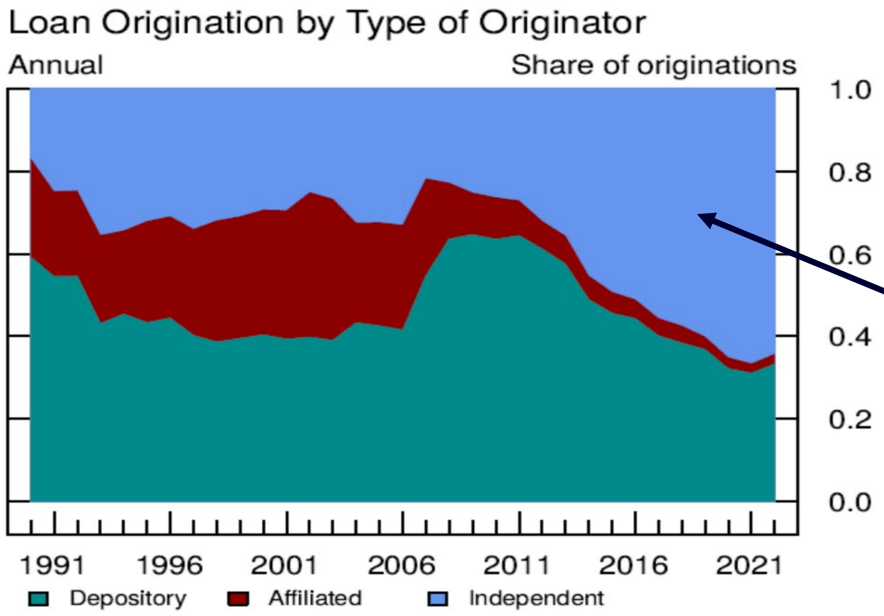
- NBFIs do not operate in isolation
- Banks heavily interconnected with NBFIs
- NBFI distress can have impact on banks (example: Archegos in 2021)

Banks supply funding to NBFIs



Source: FR Y9-C. Consolidated Financial Statements for Holding Companies

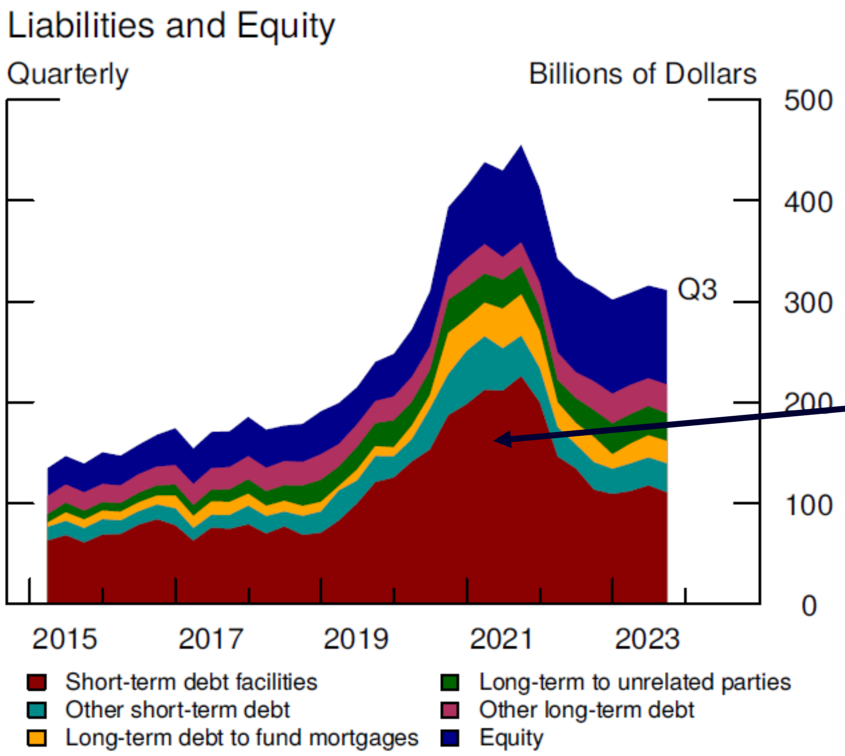
Rise of nonbank mortgage lenders ...



Source: HMDA. Figure courtesy of Karen Pence, Board of Governors, Internal Presentation

Independent (nonbank) mortgage lenders originate the majority of loans

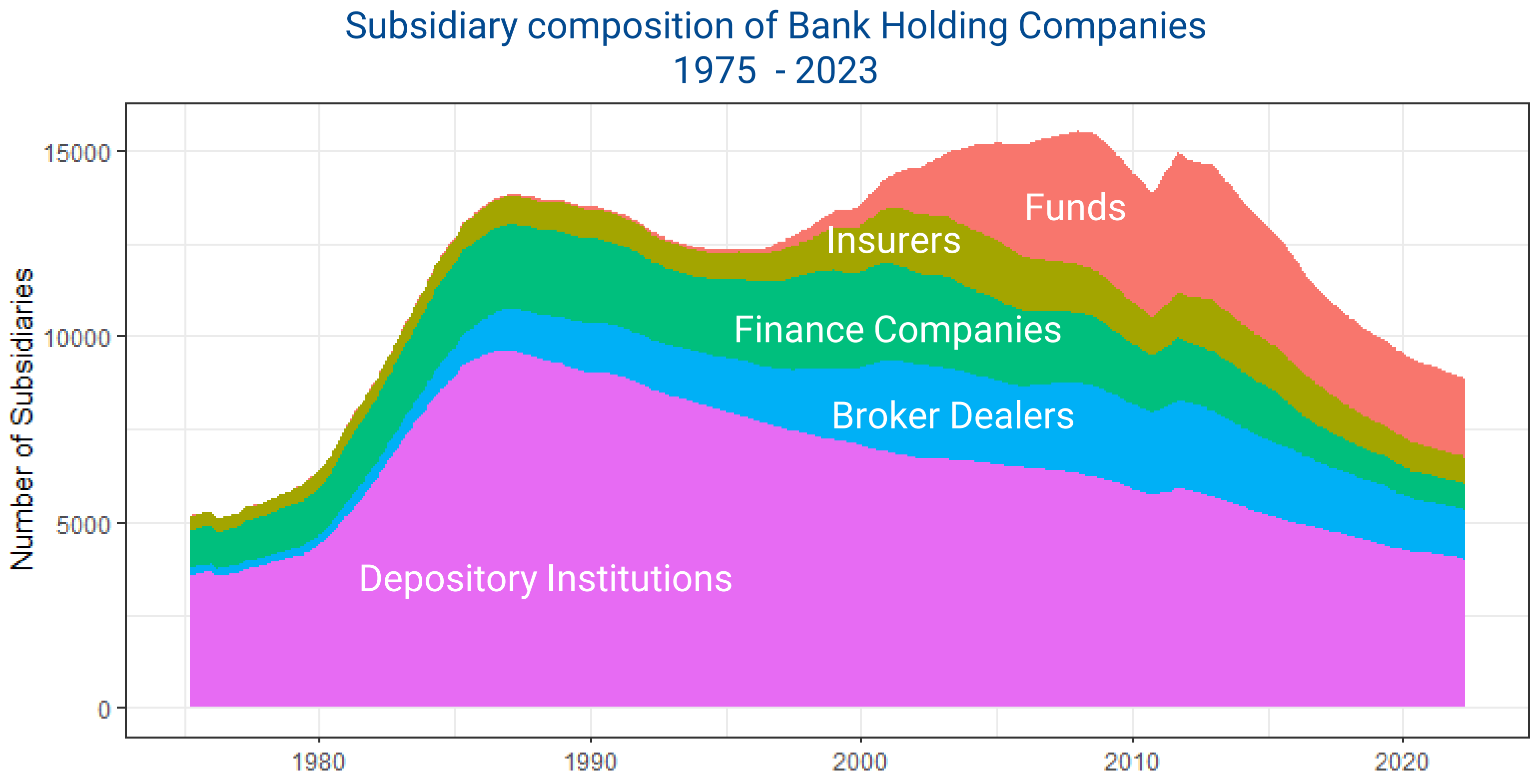
... but banks behind their growth



Source: NMLS Mortgage Call Report, Conference of State Bank Supervisors
Figure courtesy of Karen Pence, Board of Governors, Internal Presentation

Nonbank lenders highly dependent on short-term “warehouse” lines of credit to finance originations

NBFIs have also grown *inside* banks!



Source: FR Y-10, Report of Changes in Organizational Structure

Takeaways

- Long list of NBFIs as important middlemen in financial systems
- Strong growth, and outgrowing of banking institutions
- Challenges to monetary policy in a more complex system with NBFIs
- NBFIs can be vectors of shock transmission and amplification in financial systems
- Banks' growing exposures to NBFIs